Internal Revenue Service
memorandum

CC:INTL:FREV-253878-96
Br3:GFleeman

date: OCT 10 1997

to: Robert Uhar
Chief, Support and Services Branch
CP:IN:D:C:SS:QMS

from: Barbara A. Felker
Chief, CC:INTL:Br3

subject: Singapore Central Provident Fund

This memorandum supplements our memorandum of October 25, 1996 (copy attached) concerning the taxability of contributions to the Central Provident Fund ("Fund") and the earnings thereon. In that memorandum, we made the following statement:

> CC:EBEO has advised us that amounts withheld from an employee's wages and contributed to the Fund can be treated as employer contributions that are includible in the employee's gross income by reason of section 402(b) (rather than section 61). The significance of this change of position is that the amounts in question will not constitute "foreign earned income" within the meaning of section 911(b)(1)(A) and that no portion of the amounts contributed to the Fund will be eligible for exclusion from the employee's gross income under section 911(a)(1).

As you will recall, Shirley Sherwood, the RSR in Singapore, needed more information on this point before she could comfortably tell taxpayers that amounts withheld from an employee's wages are not earned income. We discussed this in a conference call with Ms. Sherwood on December 11, 1996 and agreed to provide additional advice.

CC:EBEO has now confirmed at pages 3 and 4 of a memorandum dated September 26, 1997 (copy attached) that nonelective amounts withheld from an employee's wages and contributed to the Fund are includible in the employee's gross income by reason of section 402(b) (rather than section 61):

> Because nonelective contributions withheld from an employee's salary are not withheld at the election of the employee and are not constructively received by the employee, those contributions are considered employer contributions and are taxable pursuant to § 402(b)(1). See Hicks v. United States, 205 F.Supp. 343 (W.D. Va. 1962), aff'd, 314 F.2d 180 (4th Cir. 1963); Rev. Rul. 63-180, 1963-2 [sic] C.B. 189. But

cf. Rev. Rul. 56-473, 1956-2 C.B. 22; Rev. Rul. 57-326, 1957-2 C.B. 42; Rev. Rul. 72-250, 1972-1 C.B. 22 (contrary pre-ERISA precedents that are superseded by § 414(h)).

Consequently, such amounts are not excludible from the employee's gross income under section 911. See Code §911(b)(1)(B)(iii). However, any elective amounts withheld from the employee's wages and contributed to the Fund would be includible in the employee's gross income by reason of section 61 (rather than section 402(b)) and therefore would be excludible under section 911.

Based on CC:EBEO's latest advice, we believe Ms. Sherwood should be advised that the only contributions to the Fund that are properly treated as foreign earned income for purposes of section 911 are amounts that an employee could have received in cash but elected to contribute to the Plan instead.

If you have any questions, please contact Grace Fleeman or me at (202) 622-3850.

Attachments

Internal Revenue Service
memorandum

date: SEP 26 1997

to: Chief, Branch 3
Office of the Associate Chief Counsel (International)

from: Chief, Branch 1
Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations)

subject: Singapore Central Provident Fund

At your request, we are updating our assistance regarding the Singapore Central Provident Fund as in effect for 1993, to reflect subsequent changes to this arrangement.

Under Singapore law, an employer generally must contribute a certain proportion of each employee's wages to the Singapore Central Provident Fund. The employer is permitted to withhold up to half of the amount required to be contributed from each employee's wages. The Fund is held in trust for covered employees and their beneficiaries. Accounts are maintained for each employee benefitting under the Fund, to which contributions and earnings determined each year by the Singapore government are allocated. No portion of an employee's benefit is forfeitable. Under former Singapore law, benefits from the Fund generally could be withdrawn on an employee's attainment of age 55, death, or disability.

Although the materials you have sent to us provide little detail, it appears that two pertinent sets of changes have been made to the arrangement. The first pertinent change is that distributions from the Fund may now be made for a wide variety of purposes, including use for public housing, public transportation, home insurance, private housing, health care (including medical insurance), purchase of various types of investments, parents' retirement needs, college education, and life insurance. The second pertinent change is that employees are permitted to make certain additional elective contributions to the Fund. In addition, employers are no longer required to make contributions to the Fund for certain employees who are not citizens or permanent residents of Singapore. For such an employee, mandatory contributions to the Fund are not required if the employee's Employment/Professional Visit Pass or 3-year Work Permit has expired since August 1, 1995. However, the employer and employee may continue to make mandatory contributions to the Fund through 1998 upon their joint application to the Fund's Board. Thus, it appears that the issues addressed in this memorandum will affect far fewer taxpayers in the future.

Section 83(a) of the Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount (if any) paid for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that, for purposes of § 83, the term "property" does not include an unfunded and unsecured promise to pay money or property in the future. However, the term "property" does include a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b)(1) provides that contributions made by an employer to an employees' trust that is not exempt from tax under § 501(a) are included in the employee's gross income in accordance with § 83, except that the value of the employee's interest in the trust is substituted for the property's fair market value in applying § 83.

Under § 402(b)(2), the amount actually distributed or made available to any distributee by any such trust is taxable to the distributee in the year so distributed or made available under § 72 (relating to annuities), except that distributions of income of such trust before the annuity starting date are included in the gross income of the employee without regard to § 72(e)(5).

Section 1.402(b)-1(a)(1) of the regulations provides that employer contributions to a nonexempt employees' trust shall be included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested as defined in § 1.83-3(b).

Section 402(b)(3) provides that a beneficiary of any trust described in § 402(b)(1) is not considered the owner of any portion of the trust under subpart E of part I of subchapter J. Section 1.402(b)-1(b)(6) of the regulations provides that where contributions made by the employee are not incidental when compared to contributions made by the employer, the beneficiary shall be considered to be the owner of the portion of the trust attributable to contributions made by the employee, if the applicable requirements of subpart E, part I, subchapter J, chapter I of the Code are satisfied. For purposes of this rule, contributions made by an employee are not incidental when compared to contributions made by the employer if the employee's total contributions as of any date exceed the employer's total contributions on behalf of the employee as of that date.

Section 402(b)(4)(A) provides that if one of the reasons a trust is not exempt from tax under § 501(a) is the failure of the plan of which it is a part to meet the requirements of § 401(a)(26) or § 410(b), then a highly compensated employee (as defined in § 414(q)) shall, in lieu of the amount determined under paragraph (1) or (2), include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the vested accrued benefit of the employee (other than the employee's investment in the contract) as of the close of the taxable year of the trust. Sections 410(b) and 401(a)(26) are part of a system of nondiscrimination rules a plan must satisfy to be considered a qualified plan that receives favorable tax treatment. Section 410(b) provides minimum coverage rules, pursuant to which a plan (together with certain other plans of the employer) must cover a minimum proportion of the employer's employees. Section 401(a)(26) provides minimum participation rules, pursuant to which a plan must permit a minimum number or proportion of an employer's employees to participate in the plan.

A technical correction contained in H.R. 11, 102d Cong., 2d Sess. § 6102(j)(1)(A) (1992) would have changed § 402(b)(4)(A) to provide that if one of the reasons a trust is not exempt from tax under § 501(a) is the failure of the plan of which it is a part to meet the requirements of § 401(a)(26) or § 410(b), then a highly compensated employee (as defined in § 414(q)) shall, in lieu of the amount determined under paragraph (1), include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the vested accrued benefit of the employee (other than the employee's investment in the contract) as of the close of the taxable year of the trust. H.R. 11 was passed by both the Senate and the House of Representatives but was never signed into law by the president.

As in our memorandum of October 24, 1996, we have concluded that the Fund is a nonexempt employees' trust described in § 402(b). It appears that contributions to the Fund generally are made as a uniform percentage of salary for the vast majority of each employer's employees. Thus, for most employers, Fund benefits of highly compensated employees would not be subject to the rules of § 402(b)(4)(A). However, it is possible that, if a significant number of an employer's nonhighly compensated employees are exempt from coverage under the Fund, benefits of the employer's highly compensated employees would be subject to the rules of § 402(b)(4)(A).

For an employee who is taxed under the rules of 402(b)(1), contributions paid by the employer to Fund are taxable pursuant to § 402(b)(1). Because nonelective contributions withheld from an employee's salary are not withheld at the election of the employee and are not constructively received by the employee, those contributions are considered employer contributions and are taxable pursuant to § 402(b)(1). See Hicks v. United States, 205 F.Supp. 343 (W.D. Va. 1962), aff'd, 314 F.2d 180 (4th Cir. 1963); Rev. Rul. 63-180, 1963-1 C.B. 189. But cf. Rev. Rul. 56-473, 1956-2 C.B. 22; Rev. Rul. 57-326, 1957-2 C.B. 42; Rev. Rul. 72-250, 1972-1 C.B. 22 (contrary pre-ERISA precedents that are superseded by § 414(h)). Additional contributions to the Fund made at the election of the employee are employee contributions that are taxed pursuant to § 61. As long as these additional elective contributions to an employee's account do not exceed employer contributions to the employee's account, no portion of the Fund will be considered owned by the employee under the grantor trust rules pursuant to § 402(b)(3) and § 1.402(b)-1(b)(6).

Under § 402(b)(2), interest income earned on an employee's portion of the Fund is taxable when amounts are distributed or made available from the Fund, in accordance with the rules of § 72 (concerning calculation of an exclusion ratio and application of this ratio to amounts distributed). Under § 1.451-2(a), amounts are considered made available from the Fund whenever a participant would be entitled to receive the distribution upon giving notice of intent to withdraw those amounts. Thus, the availability of distributions from the Fund for a wider variety of purposes under the changes made to the Fund may result in the taxation of amounts made available from the Fund under § 402(b)(2) in a greater variety of circumstances.

In the rare case in which § 402(b)(4) applies to a highly compensated employee's benefit under the Fund, such an employee would be taxed on his vested accrued benefit under the Fund (other than the previously taxed portion of the employee's Fund benefit) as of the end of each year. In this case, such an employee would, in effect, be taxed currently on the earnings attributed to his Fund balance as well as on contributions made on his behalf to the Fund. The tax consequences to such an employee of distributions from the Fund are unclear. Section 402(b)(4)(A) of the Code in its current form does not apply § 402(b)(2) to trigger application of § 72 to distributions to a highly compensated employee from a nonexempt trust to which § 402(b)(4)(A) applies. However, under the technical correction described above contained in H.R. 11, 102d Cong., 2d Sess. § 6102(j)(1)(A) (1992), a distribution to a highly compensated employee from a nonexempt employees' trust to which § 402(b)(4)(A) applies would be taxed under § 72 (relating to annuities). From this proposed technical correction, it appears that Congress intended to tax distributions to highly compensated employees from nonexempt employees' trusts in accordance with the rules of § 72. Accordingly, the tax consequences of distributions from the Fund are unclear in cases in which § 402(b)(4)(A) applies.

Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Reviewer
Code CC:EBEO: EBEO 1					
Surname [illegible]					